

FAIR POLITICAL PRACTICES COMMISSION

Memorandum

To: Chairman Randolph and Commissioners Blair, Huguenin, Leidigh and Remy

From: Valentina Joyce, Commission Counsel, Legal Division
Luisa Menchaca, General Counsel

Subject: Prenotice Discussion of Amendment to Recordkeeping Requirements: Electronically Processed Checks - Regulation 18401.

Date: December 20, 2006

I. Executive Summary

Section 84104 of the Political Reform Act (the “Act”)¹ establishes a duty of candidates, treasurers, and elected officers to maintain detailed accounts, records, bills, and receipts necessary to prepare campaign statements and to establish that campaign statements were properly filed. Regulation 18401 identifies the records that must be maintained. Subsection (a)(4)(B) defines what documents must be maintained as “original source documentation” for expenditures of \$25 or more, or a series of payments for a single product or service that totals \$25 or more. It provides, in pertinent part, that original source documentation shall consist of cancelled checks made from any checking or savings account or any other campaign accounts.

Since adoption of this regulation, many banks no longer return original cancelled checks to their customers. Federal law allows banks to process checks by capturing a picture of the front and back of the check along with the associated payment information and transmit this information electronically. Paper checks no longer need to be physically moved from one bank to another to be honored. After the electronic image of the check is transmitted to the payer bank, a “substitute check” is created, which is processed within hours rather than days. Checks processed in this manner are commonly referred to as “electronic checks.”

By referring simply to “cancelled checks” as original source documentation, regulation 18401(a)(4)(B) does not contemplate electronic processing of checks. The proposed amendment would include documentation for the processing of electronic checks within the regulation’s requirement for maintaining original source documentation.

¹ Government Code sections 81000 – 91014. Commission regulations appear at title 2, sections 18109 – 18997, of the California Code of Regulations. All statutory references are to the Government Code unless otherwise indicated.

II. Issue

What form of original source documentation should be required for expenditures of \$25 or more?

III. Background

Section 84104 of the Act provides in pertinent part:

“It shall be the duty of each candidate, treasurer, and elected officer to maintain detailed accounts, records, bills, and receipts necessary to prepare campaign statements, to establish that campaign statements were properly filed, and to otherwise comply with the provisions of this chapter . . .”

The statute is silent as to what detailed information and what backup records are “necessary” to support the information disclosed on campaign statements. Until 1992, regulation 18401 did not specify the requisite recordkeeping requirements. It merely made reference to a separate Fair Political Practices Commission (FPPC) manual that identified what records and documents should be maintained and created a “safe harbor” for those who maintained records in “good faith reliance on the manual.” The Franchise Tax Board (FTB) and the Commission felt this was inadequate to further the purpose of section 84104 of the Act and in 1992 amended regulation 18401 to codify much of what was in the manual, including the concept of “original source documentation.” The 1992 amendments endeavored to specify in detail what original source documentation must be retained in order to ensure compliance and facilitate enforcement of the Act’s reporting requirements.

The records retention rules serve a vital purpose under the Act. Section 90001 *et seq.* provides for the auditing of certain committees either by the FTB or the Commission. Section 90007 requires the Commission to adopt auditing guidelines and standards “to encourage compliance and detect violations” of the Act. One such guideline, appearing in regulation 18995(b)(4), states that “[s]ufficient, competent evidence, including source documents, is to be obtained through inspection, observations, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the filing under examination.”

Accordingly, auditors are instructed to examine records and documents that are more specifically described in regulation 18401. Regulation 18401(a)(4) specifies what records and documents must be maintained for an expenditure of \$25 or more, or a series of payments for a single product or service which totals \$25 or more:

“(A) The accounts and records shall contain the date the expenditure was made (or, for an accrued expense, the date of goods or services were received), the amount of the expenditure, the full name and

street address of the payee, and a description of the goods or services for which each expenditure was made. If the person or vendor providing the goods or services is different from the payee, the accounts and records shall contain the same detailed information for such person or vendor. For an expenditure which is a contribution to another candidate or committee, or is an independent expenditure, the records shall contain the cumulative amount of such contributions to, or independent expenditures to support or oppose, each candidate, committee, or ballot measure.

“(B) The original source documentation shall consist of cancelled checks, wire transfers, credit card charge slips, bills, receipts, invoices, statements, vouchers, and any other documents reflecting obligations incurred by the candidate, elected officer, campaign treasurer, or committee, and disbursements made from any checking or savings account, or any other campaign accounts, in any bank or other financial institution.”

The primary distinction between “records” (subparagraph (A) above) and “original source documentation” (subparagraph (B) above) is that original source documents generally come from external sources. Records, such as ledgers or bank registers, can be created by the person preparing the campaign statement. Original source documents, however, generally come from banks, vendors, and other third parties. Another distinction is indicated from dictionary definitions which imply that “records”² are compilations of information *describing* transactions, while “documents”³ are *proof* of the underlying transaction. For these reasons, auditors consider a cancelled check to be the best evidence of an expenditure.

IV. Proposed Amendment

On October 28, 2004, the Check Clearing for the 21st Century Act (12 USC 5001, commonly referred to as “Check 21”) went into effect, authorizing banks to handle paper checks electronically in order to enable faster and more efficient check processing. Therefore, most banks now process checks electronically and send customers copies of “substitute checks”⁴ or image statements⁵ instead of cancelled checks.

² A written account of proceedings.

³ A paper that furnishes information, proof, or support of something else.

⁴ Check 21 defines “substitute check” as a paper reproduction of the original check that (A) contains an image of the front and back of the original check; (B) bears a magnetic ink character recognition line (MICR) containing all the information appearing on the MICR line of the original check, except as provided under generally applicable industry standards for substitute checks to facilitate the processing of substitute checks; (C) conforms, in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks; and (D) is suitable for automated processing in the same manner as the original check. A substitute check is slightly larger than a standard personal check.

⁵ An image statement is an 8 ½ by 11 inch page showing multiple pictures of cancelled checks per page. The pictures on the image statement could represent an original check or a substitute check.

A substitute check is legally the same as the original check if it accurately represents the information on the original check and includes the statement: “This is a legal copy of your check. You can use it in the same way you would use the original check.”

Substitute checks are usually requested and paid for by the customer or can be printed from an online Internet banking account. Image statements are routinely mailed to customers with their monthly statements. Some financial institutions only provide statements and images of cancelled checks via the Internet.

Substitute checks and image statements, whether mailed to the customer or downloaded from the Internet, do not currently satisfy the regulation’s requirement for cancelled checks. Therefore, regulation 18401 needs to be amended to permit recordkeeping of electronically processed cancelled checks and also satisfy the need of auditors to “obtain sufficient competent evidence including source documents

The proposed amendment would permit copies of cancelled checks that have been electronically processed as original source documentation by adding the following language:

“In lieu of cancelled checks, the original source documentation may consist of copies of cancelled checks that contain a legible true-to-size image of the front and back of the cancelled check, provided the copy was obtained from the financial institution.”

This language would permit using copies of original cancelled checks, substitute checks or checks downloaded from the Internet as long as the copies:

- are copies of “cancelled checks,” i.e., checks that have been approved for payment and have cleared the appropriate account of a financial institution;
- are “legible and true-to-size,” to avoid relying solely on the use of image statements containing very small images of checks that may be difficult or impossible to read;
- include images of the front and back of the check; and
- are obtained from the financial institution.

VI. Staff Recommendation

Staff recommends noticing for public comment a proposed regulation amending regulation 18401(a)(4)(B) to add this provision.

Attachment

Proposed Amendment to Regulation 18401.